

Nebraska Taxation of Contractors Option 2

Effective July 1, 2004

For more information, check our
Web site: www.revenue.state.ne.us



This Information Guide provides an overview of the application of sales and use tax to contractors operating under Option 2. It is not designed to answer all questions that might arise, but is intended to enable a person to become familiar with the main provisions of this contractor option.

Overview

Under Option 2, the contractor is a **retailer** of construction services and the **consumer** of all building materials and fixtures purchased and annexed to real property. Option 2 contractors must pay tax on their purchase of building materials and fixtures and maintain a tax-paid inventory of such items. As a retailer, an Option 2 contractor must be licensed for Nebraska sales tax. The required sales tax permit is obtained by filing a Nebraska Tax Application, Form 20. An Option 2 contractor must collect tax on retail sales of property, contractor labor, and other taxable services.

Construction Services means annexing building materials to real estate, repair of a structure, or repair of building materials that are, or will be, annexed to real estate. Construction services includes the installation, construction, servicing, or removal of property used in conjunction with the furnishing, installing, or connecting of telephone, telegraph, cable TV, and mobile telecommunications services. Construction services does not include the cost of the raw land or finished lot, impact fees, title insurance, property insurance, lenders fees, closing costs, inspection fees, real estate brokerage commissions, or any other taxes or fees levied on the transfer of real property.

Choosing an Option

Contractors choosing to operate under Option 2 must file a Nebraska Sales and Use Tax Election for Persons Making Repairs or Improvements to Real Estate, Form 16. This form must be filed with the Department of Revenue within three months after beginning to operate as a contractor.

Building Materials and Fixtures

- **Building Materials** are those items that will become real estate or are annexed to real estate. Examples include lumber, drywall, and electrical wire.
- **Fixtures** are pieces of equipment that must be annexed to a building or structure in order to properly function, yet remain identifiable as separate items. Examples include water heaters, furnaces, central air conditioners, and built-in dishwashers.

Option 2 contractors must pay tax on all building materials and fixtures at the time of purchase and maintain a tax-paid inventory of such items. When building materials and fixtures are purchased and no Nebraska sales tax was paid (purchases from an out-of-state supplier, for example), the contractor must remit consumer's use tax on the cost of such items directly to the Department. Nebraska sales or use tax is due on all building materials and fixtures delivered to the contractor in Nebraska, even if such items will be withdrawn from inventory and annexed to real property in another state. Option 2 contractors cannot obtain a refund or credit of use tax paid on building materials and fixtures withdrawn from inventory in Nebraska for annexation to real estate in another state unless the building materials and fixtures were purchased from an out-of-state supplier who is not required to collect Nebraska sales tax.

Purchase of Tools, Equipment, Supplies, and Taxable Services

Option 2 contractors are considered the **consumer** of all tools, equipment, and supplies that do not become part of the real estate, structure, or fixture. Contractors must pay sales tax or remit consumer's use tax on the purchase or rental of tools, equipment, and supplies. Examples include hammers, sandpaper, paint thinner, lumber to build forms, office equipment, backhoes, scaffolding, cement mixers, and safety equipment such as barriers, fences, and caution tape.

A contractor's purchases of services, such as building cleaning or maintenance services, pest control services, and security services are taxable. These services cannot be purchased for resale by a contractor.

Contractors must pay sales tax or remit consumer's use tax on the above property and services even on an exempt contractor labor project or on a project performed for an exempt entity. Use tax is commonly due on the purchase or rental of such items and services from out-of-state retailers.

Sale for Resale (Contractor to Contractor)

Option 2 contractors may purchase contractor labor from another contractor tax-free for resale. Option 2 contractors may also sell their contractor labor tax-free to another contractor. In order for a purchase or sale of contractor labor to be made tax-free, the contractor making the purchase must give the contractor selling such labor a properly completed Nebraska Resale or Exempt Sale Certificate, Form 13, Section A.

Option 2 contractors **cannot** purchase building materials or fixtures owned and annexed by another contractor or a retailer's pest control services, security services, or building cleaning services for resale.

Taxable Contractor Labor Projects

Billings Between Contractors. When an Option 2 contractor bills another contractor it will not collect sales tax, provided the other contractor issues a properly completed Nebraska Resale or Exempt Sale Certificate, Form 13, Section A.

Billing Project Owners. When an Option 2 contractor bills the project owner for a taxable labor project, the contractor will collect and remit sales tax when payments are received at the rate in effect at the project location. Regardless of its billing method (one charge or separate charges), taxable contractor labor is determined by multiplying the total amount billed by the appropriate **contractor labor percentage** listed below. These percentages must be used to determine the taxable amount of contractor labor regardless of the **actual** material and labor charges.

Total Tax Rate (at project location)	Contractor Labor Percentage
7.0%	57.2%
6.5%	57.4%
6.0%	57.6%
5.5%	57.8%

See our Web site for an explanation of the calculation of these contractor labor percentages.

Example 1: An Option 2 contractor is hired as a general contractor to remodel a customer's kitchen for \$25,000. The project is located in a city with a 1.5 percent local tax rate for a total rate of 7.0 percent. Sample contractor invoice issued to the project owner:

Materials (cabinets)	\$8,000.00
Labor	17,000.00
Total sales price	\$25,000.00
Taxable Contractor Labor ($\$25,000 \times 57.2\% = \$14,300$)	
Sales tax ($\$14,300 \times 7.0\%$)	1,001.00
Total amount due	\$26,001.00

Example 2: An Option 2 contractor is hired as a general contractor to remodel a customer's kitchen for \$30,000. The project is located in a city with a 1.5 percent local tax rate for a total rate of 7.0 percent. The general contractor hires an Option 1 electrician and an Option 2 or Option 3 plumber. The general contractor issued each subcontractor a properly completed Nebraska Resale or Exempt Sale Certificate, Form 13, Section A, to purchase the subcontractors' labor tax free.

The Option 1 electrician will collect sales tax from the general contractor on its separately stated charge for materials. If the Option 1 electrician charges a single amount for its materials and labor, the total charge is taxable.

Sample invoice from the Option 1 electrician to the Option 2 general contractor:

Labor	\$2,000.00
Materials (wire)	600.00
Sales Tax ($\$600 \times 7.0\%$)	42.00
Total amount due	\$2,642.00

Option 2 contractors must pay sales tax on the amounts charged for **materials** by Option 1 subcontractors.

Regardless of its billing method (one charge or separate charges), the Option 2 or Option 3 plumber who has received a Form 13 will not collect sales tax on any portion of its bill in the following invoice.

Sample invoice from an Option 2 or Option 3 plumber to the Option 2 general contractor:

Plumbing for kitchen remodel	\$3,000.00
Total amount due	\$3,000.00

The Option 2 general contractor must collect sales tax from the project owner on contractor labor using the appropriate contractor labor percentage. Sample invoice to the project owner:

Kitchen remodel	\$24,358.00
Wiring	2,642.00
Plumbing	3,000.00
Total sales price	\$30,000.00
Taxable Contractor Labor ($\$30,000 \times 57.2\% = \$17,160$)	
Sales Tax ($\$17,160 \times 7.0\%$)	1,201.20
Total amount due	\$31,201.20

Labor-only Contracts

Option 2 contractors who are hired to annex building materials or fixtures owned by another person (labor-only contract) are required to collect sales tax on the contractor labor percentage of the gross receipts.

Telephone, Telegraph, Cable TV, and Mobile Telecommunications Services

The labor involved to install, construct, service, or remove property used in conjunction with the above utility services is taxed in the same manner as contractor labor. The taxation of property used in providing the above services is dependent upon whether the property is annexed or remains tangible personal property after it is installed.

Exempt Contractor Labor Projects

Option 2 contractors will not collect sales tax from the customer on any building materials or contractor labor billed in connection with the following types of construction projects. However, an Option 2 contractor must pay tax on its purchase of building materials and fixtures used in performing an exempt labor project.

- 1 The first or original construction of a building or other structure;
- 2 The addition of an entire room or floor (story) to any existing building. The addition must actually increase the square footage of the building and the number of rooms or floors in the existing building. The exemption is limited to the charges associated with: the construction of the new room or floor, that part of the existing wall, floor, or ceiling that is altered to accommodate the point of access between the new room or floor and the existing building, and any electrical, plumbing, heating, or cooling system modifications needed to support the new room or floor;
- 3 The completion of an unfinished portion of an existing building or structure;
- 4 The restoration, reconstruction, or replacement of a building or structure damaged or destroyed by fire, flood, tornado, lightning, explosion, ice storm, or natural disaster;
- 5 The construction, repair, or annexation of any structure used for the generation, transmission, or distribution of electricity; or
- 6 The major renovation of an existing building or unit of an existing building when at least 75 percent of the square feet of the building or unit is renovated. The exemption is conditioned on meeting the requirements as set forth below.

A **major renovation** is a single renovation project of an existing building or a unit of an existing building that involves the rehabilitation, replacement, or reconfiguration of walls or fixtures.

A **unit** is a physical portion of a building designated for separate ownership, rental, or occupancy, such as an apartment.

75% Major Renovation

The 75% major renovation exemption is the only exemption category that requires filing either a Notification or Application for Approval of a Major Renovation with the department. The general contractor must retain a copy of the Acknowledgment or approved Application for Approval to document why sales tax was not billed on the contractor labor charged to the project owner. A Form 13 is used to document tax-free sales of contractor labor between contractors. A copy of the Acknowledgment or approved Application for Approval is not required to be given to subcontractors when a Form 13 is completed. The following information explains the requirements that must be met for the major renovation exemption.

Notification and Acknowledgment. On a major renovation of a single-family dwelling or a duplex, a Notification may be submitted to the department containing information relating to the construction project. This Notification is to be submitted by the general contractor, or if there is no general contractor, by the project owner. Upon receipt of the properly completed Notification, the department will issue an Acknowledgment. The Notification form can be obtained from the department and is available on its Web site.

Approval of a Major Renovation for a Commercial or Industrial Building. An Application for Approval of a Major Renovation must be filed along with the required application fee of five hundred dollars for any construction project that is not a single-family dwelling or a duplex, in order to exempt the contractor labor from tax. The Application for Approval is to be supported by designs, plans, specifications, or other materials, and signed by a licensed architect or engineer, indicating the extent of the renovation, the work that is planned to be performed, and the square footage of the floor space that is to be renovated.

The Notification and Acknowledgment process is not allowed for commercial or industrial projects. However, the Application for Approval may be used for a major renovation on a single-family dwelling or duplex.

100% Major Renovation — Refund of Tax on Contractor Labor

When the major renovation of an existing building or unit of an existing building in a single renovation project increases the market value of the building or unit by at least 100 percent, the taxpayer may apply to the department for a refund of tax paid to the contractor for contractor labor. The refund claim must include sufficient documentation to substantiate the amount of sales tax paid on contractor labor and the change in market value of the property. The method used to determine the market value of the property (by appraisal or assessor's property tax valuation), both before and after the completion of the project, must be the same.

Contracts with Exempt Entities

When performing work for a qualified exempt entity or exempt governmental unit, the Option 2 contractor must obtain a Purchasing Agent Appointment and Delegation of Authority for Sales and Use Tax, Form 17, **and** a Form 13, Section B, from the exempt project owner. The Form 17 must be completed and issued BEFORE any materials are annexed.

Most nonprofit organizations are NOT exempt from sales tax in Nebraska. In addition, not all governmental units are exempt from Nebraska sales tax.

For specific details regarding who is exempt from sales tax, please refer to the following:

■ Nebraska Sales and Use Tax Regulations

- 1-012, Exemptions
- 1-090, Nonprofit Organizations
- 1-091, Religious Organizations
- 1-092, Educational Institutions
- 1-093, Governmental Units

■ Information Guides

- Nonprofit Organizations
- Governmental Units
- Consumer's Use Tax

In order to purchase contractor labor, building materials, and fixtures tax-free for a project with an exempt entity, Option 2 contractors must give their subcontractors and suppliers a copy of Form 17, **and** a properly completed Nebraska Resale or Exempt Sale Certificate, Form 13, Section B. Form 13 is completed by the contractor indicating the name of the exempt project owner and must be signed by the contractor.

Option 2 contractors may withdraw tax-paid building materials and fixtures from inventory for incorporation into an exempt project. To recover the tax paid on such items, the contractor may take a credit against its current consumer's use tax liability, or file a Claim for Overpayment of Sales and Use Tax, Form 7, and receive a refund of the tax paid on such building materials and fixtures.

Purchase of Tools, Equipment, Supplies, and Taxable Services. Contractors engaged in construction projects with entities that are exempt from sales tax in Nebraska must pay tax on the purchase, rental or lease of tools, equipment, and supplies that will not become annexed to or incorporated into real property.

A contractor's purchases of services, such as building cleaning or maintenance services, pest control services, and security services are taxable, even when the contractor is engaged in a construction project for an exempt entity. These services cannot be purchased for resale by a contractor.

Other Retail Sales Made by Contractors

Building Cleaning and Maintenance Services

Persons, including Option 2 contractors, performing cleaning and maintenance services on buildings, central air conditioning units, furnaces, and other fixtures must collect sales tax on the total charge for such services. However, when Option 2 contractors make repairs to buildings and fixtures, they must use the appropriate contractor labor percentage. Sales tax must be paid on purchases of equipment and supplies used in performing these services.

Warranties, Guarantees, Maintenance Agreements, and Service Contracts

Sales of warranties, guarantees, maintenance agreements, and service contracts that cover the repair, cleaning, or maintenance of buildings, and fixtures, or the repair of a structure, are subject to tax. An Option 2 contractor who sells these agreements must collect sales tax on the total amount charged for such contracts. Any building materials used in the performance of such contracts can be purchased tax-free for resale. Option 2 contractors who annex tax-paid building materials in the performance of such contracts may obtain a credit for the tax paid on such materials by taking an adjustment on line 13 of their Nebraska Schedule III, Form 10. Sales tax must be collected on parts, materials, labor, or any other charge that is not covered under the agreement. For additional information see Nebraska Sales and Use Tax Regulation 1-074.

Over-the-Counter Sales

Over-the-counter sales are sales of property that is not annexed to a building or structure by the contractor. When making over-the-counter sales, the contractor must collect the Nebraska and any applicable local sales tax on the total sales price to the customer.

Option 2 contractors who make over-the-counter sales of their tax-paid building materials can obtain a credit for the tax paid on such materials by taking an adjustment on line 13 of their Nebraska Schedule III, Form 10.

Taxable Labor, Other Than Contractor Labor

Labor performed on tangible personal property, such as production labor, assembly labor, repair labor, and installation labor, whether performed by a contractor or other person, are taxable. Additional information on these other types of labor can be found in Nebraska Sales and Use Tax Regulation 1-082, which is available on our Web site.

Remitting the Tax

Sales tax collected from customers on retail sales and consumer's use tax due on building materials, fixtures, tools, equipment, supplies, and taxable services on which no Nebraska sales tax has been paid are remitted with the Nebraska and Local Sales and Use Tax Return, Form 10.

When completing the Form 10, Schedule III, line 1, gross sales and services should include the total amount received for construction and repair projects and the total amount of "other

retail sales." Any deductions from gross sales for nontaxable receipts are reported on lines 2 through 13 of the Schedule III.

On and after July 1, 2004, an Option 2 contractor cannot deduct from its gross sales and services the cost of tax-paid subcontracts or tax-paid materials which are annexed pursuant to a construction project. Additional information regarding the completion of the Form 10 may be found in our Nebraska and Local Sales and Use Tax Return, Form 10, Information Guide.

Example for remitting the tax: The facts and amounts used below were taken from Example 1 in the Taxable Contractor Labor Projects section of this guide. The Option 2 general contractor's gross receipts of \$25,000 are reported on line 1 of both Form 10 and Schedule III. A deduction is taken on line 13 of Schedule III for the portion of gross receipts not taxed. The deduction is computed by subtracting the taxable contractor labor from gross receipts (\$25,000 - \$14,300 = \$10,700).



NEBRASKA SCHEDULE III — Computation of Net Taxable Sales and Nebraska Consumer's Use Tax

• Print your name, I.D. number, and tax period on this schedule

**FORM
10**

Name as Shown on Form 10

Nebraska I.D. Number

Tax Period

COMPUTATION OF NET TAXABLE SALES

1	Gross sales and services (enter on line 1 of Form 10)	1	25,000	00
13	Other allowable deductions (explain)	13	10,700	00
15	Net taxable sales (line 1 minus line 14). Round to nearest dollar and enter on line 2 of Form 10	15	14,300	00



Nebraska and Local Sales and Use Tax Return

• Complete Schedule III on reverse side

**FORM
10**

PLEASE DO NOT WRITE IN THIS SPACE

Tax Cat. | Nebr. I.D. Number | Rpt. Code | Tax Period

1	Gross sales and services (as reported on Nebraska Schedule III)	1	\$	25,000	00
2	Net taxable sales (as reported on Nebraska Schedule III)	2		14,300	00

Record Keeping

If your contractor labor charges are exempt from tax you must keep a copy of the Form 13; otherwise, it is necessary to keep construction contracts, building permits, bid or building specifications, purchase orders, billing invoices, blueprints, drawings, Department of Revenue acknowledgments or approved applications, and any other documentation to accurately describe the construction work that was completed.

Other Contractor Options

There are two other options available to contractors. For information on the sales and use tax responsibilities under Option 1 or Option 3, please refer to the appropriate information guide. Copies may be obtained directly from the department or from the department's Web site.

Changing Options

Contractors may change their option by filing another Form 16. However, contractors may not operate under more than one option

at the same time. All jobs in progress must be under the same option.

Changes become effective on the first day of the next month when the Form 16 is received on or before the 15th of the month. If the Form 16 is received after the 15th of the month the change becomes effective one month later.

Option 1 or Option 3 contractors with a tax-free inventory and who are changing to Option 2 requiring a tax-paid inventory, must pay tax on all building materials and fixtures in inventory at the time the change is made. Documentation indicating the tax calculation and the tax payment must be attached to the Form 16.

Option 2 contractors with a tax-paid inventory and who are changing to Option 1 or Option 3 will receive a credit for tax previously paid on their current inventory. The contractor must submit with the Form 16, documentation detailing the amount of tax and substantiating the credit. The department will issue a credit on the contractor's account to offset future sales and use tax liabilities. The contractor is not entitled to a refund of the tax previously paid on the inventory.

FOR NEBRASKA TAX ASSISTANCE

For All Tax Programs Except Motor Fuels

Contact your regional office or call **1-800-742-7474** (toll free in NE and IA)

or **1-402-471-5729**

Nebraska Department of Revenue Web site address: www.revenue.state.ne.us

A copy of the Taxpayer Bill of Rights is available by calling any of our regional offices or visiting our Web site.

SCOTTSBLUFF

Panhandle State Office Complex
4500 Avenue I, Box 1500
Scottsbluff, Nebraska 69363-1500
Telephone (308) 632-1200

NORTH PLATTE

Craft State Office Building
200 South Silber Street
North Platte, Nebraska 69101-4200
Telephone (308) 535-8250

GRAND ISLAND

TierOne Bank Building, Suite 460
1811 West Second Street
Grand Island, Nebraska 68803-5469
Telephone (308) 385-6067

NORFOLK

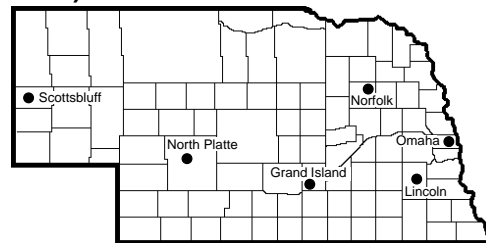
304 North 5th Street, Suite "D"
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1313 Farnam-on-the-Mall
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LINCOLN

Nebraska State Office Building
301 Centennial Mall South
Lincoln, Nebraska 68509-4818
Telephone (402) 471-5729



For Motor Fuels tax programs only call toll free 1-800-554-3835 (Lincoln residents call 471-5730).

Hearing-impaired individuals may call the Text Telephone (TT) at 1-800-382-9309. TDD (Telecommunications Device for the Deaf) is designated by the use of "TT," which is consistent with the Americans with Disabilities Act.